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BEFORE THE ARIZONA CORPORATION COM.

Arizona Corporation Commission

DOCKETED

MAY 01 2000

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Chairman

JAMES M. IRVIN

Commissioner

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Commissioner

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IN THE MATTER OF INVESTIGATION)
 INTO U S WEST COMMUNICATIONS,)
 INC.'S COMPLIANCE WITH CERTAIN)
 WHOLESALE PRICING REQUIREMENTS)
 FOR UNBUNDLED NETWORK)
 ELEMENTS AND RESALE DISCOUNTS)

DOCKET NO. T-00000A-00-0194

AT&T COMMUNICATIONS OF
 THE MOUNTAIN STATES, INC.'S
 NOTICE OF FILING REBUTTAL
 TESTIMONY OF DOUGLAS
 DENNEY

AT&T Communications of the Mountain States, Inc. hereby files the Rebuttal
 Testimony of Douglas Denney in the above-referenced matter. A copy of which is
 attached to this notice.

Respectfully submitted this 1 day of May, 2000.

AT&T COMMUNICATIONS OF
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CERTIFICATE OF SERVICE

I hereby certify that the original and 10 copies of the Rebuttal Testimony of Douglas Denney on behalf of AT&T Communications of the Mountain States, Inc., regarding Docket No. T-00000A-00-0194, were hand delivered on this 1st day of May, 2000, to:

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Docket Control - Utilities Division
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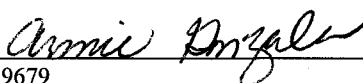
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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF INVESTIGATION)
INTO U S WEST COMMUNICATIONS,)
INC.'S COMPLIANCE WITH CERTAIN) DOCKET NO. T-00000A-00-0194
WHOLESALE PRICING)
REQUIREMENTS FOR UNBUNDLED)
NETWORK ELEMENTS AND RESALE)
DISCOUNTS)

REBUTTAL TESTIMONY OF

DOUGLAS DENNEY

ON BEHALF OF

AT&T COMMUNICATIONS

OF THE MOUNTAIN STATES, INC.

MAY 1, 2000

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	DEAVERAGED UNES.....	2
III.	CONCLUSION.....	7

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Douglas Denney. I work at 1875 Lawrence Street, Denver, Colorado.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am an economist for AT&T in its Local Services and Access Management Organization.

Q. ARE YOU THE SAME DOUGLAS DENNEY WHO FILED DIRECT TESTIMONY IN THIS DOCKET ON APRIL 24, 2000?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of this testimony is to compare U S WEST's deaveraging proposal to AT&T's proposal and rebut the April 24, 2000 direct testimony of U S WEST's witness, Teresa K. Million filed in this docket.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. Deaveraged loop rates that are based on costs will help to stimulate competition in the state of Arizona. The appropriate methodology for establishing cost-based rates is to create deaveraged wholesale rate zones that reflect significant cost differences that exist within the state. Only cost-based rates will send the

1 appropriate signals to the market and allow efficient competition to develop
2 within the state.

3 U S WEST deaveraged loop proposal seeks to limit competition in the state by
4 creating rates that are deaveraged as little as possible. U S WEST zones
5 erroneously rely upon U S WEST's current retail rate zone proposal, are not based
6 on costs, and exhibit very little deaveraging.

7 In contrast, AT&T's proposal is based on significant cost differences that exist
8 between different geographic areas within the state. AT&T's proposal will best
9 promote efficient competition in the state of Arizona.

10 **II. DEAVERAGED UNES**

11 **Q. PLEASE SUMMARIZE U S WEST'S PROPOSAL FOR DEAVERAGING**
12 **UNES AND COMPARE IT TO AT&T'S PROPOSAL.**

13 A. U S WEST proposes to deaverage the unbundled loop into "three cost-related"¹
14 zones. U S WEST zones are based on their current retail rate un-deaveraging
15 proposal and places 95% of the loops into zone one, which results in virtually no
16 deaveraging at all.

¹ Direct Testimony of Teresa K. Million, page 3, line 1.

1 AT&T's proposal deaverages the unbundled loop into five cost based zones. The
2 AT&T proposal calculates cost at the wire center level and then assigns customers
3 to zones by grouping wire centers with similar costs together.

4 The table below, summarizes the results of U S WEST's and AT&T's proposal:

Zone	AT&T Proposal		U S WEST proposal	
	Loop Cost	% of Lines	Loop Cost	% of Lines
1	\$12.75	12.0%	\$20.12	94.7%
2	\$17.05	58.1%	\$40.65	2.0%
3	\$21.98	9.7%	\$63.70	3.3%
4	\$27.40	9.4%		
5	\$53.94	10.8%		
average	\$21.98		\$21.98	

5

6 **Q. WHAT ARE THE PROBLEMS WITH U S WEST'S PROPOSAL?**

7 A. There are three major problems with U S WEST's deaveraging proposal.

8 1) U S WEST bases its wholesale deaveraging proposal on its current retail
9 deaveraging proposal.

10 2) U S WEST's deaveraged zones are not cost based.

11 3) U S WEST's proposal results in virtually no deaveraging at all.

12 **Q. WHY IS IT INAPPROPRIATE TO BASE WHOLESALE COSTS ON THE**
13 **RETAIL COST STRUCTURE?**

14 A. First, retail rates do not determine wholesale rates. In fact, the opposite
15 relationship exists. Wholesale rates are one factor in influencing retail rates.

1 The purpose of the deaveraging requirement is to facilitate competition by
2 sending the appropriate cost signals to the market place. Thus, the deaveraged
3 loop rate should be based on cost, not on a retail rate structure.

4 U S WEST acknowledges this when they say, "wholesale rates *drives* the
5 deaveraging of retail rates."² Though U S WEST's belief that wholesale and retail
6 rates are "inextricably linked"³ is in error, they are correct in the causal
7 relationship that wholesale rates influence retail rates.

8 The "inextricable link" between retail and wholesale rates is hardly a market
9 reality. Retail rates tend to be driven as much or more by consumer wants, supply
10 and demand, and marketing plans than geographic cost differences. Numerous
11 examples can be seen in every day life. Long distance carriers tend to offer one
12 rate across the country even though costs vary between and within states. Airlines
13 often charge lower prices for a flight from Phoenix to New York than Phoenix to
14 Denver, even though the costs of getting to Denver is undoubtedly cheaper. Fast
15 food restaurants market national pricing of popular food items even though labor
16 and rent vary across geographic territories.

17 Clearly, companies don't plan on losing money, thus their pricing packages tend

² Direct Testimony of Terresa K. Million, page 6, lines 6-7

³ Direct Testimony of Teresa K. Millio, page 6, line 5

1 to recover total costs. The recovery of total costs hardly leads to an “inextricable
2 link” between wholesale and retail rates within distinct geographic areas.

3 Second, as I understand U S WEST’s current retail price deaveraging proposal,
4 U S WEST is seeking to expand the base rate area, in effect, reducing the degree
5 of retail rate deaveraging that currently exists in Arizona. U S WEST’s current
6 retail rate plan is an averaging of the current rate structure, not a deaveraging.

7 Thus, basing a wholesale deaveraging cost proposal on an averaging retail rate
8 proposal is absolutely in conflict with the intent and purpose of the FCC’s rule to
9 deaverage wholesale rates.

10 **Q. WHY DO YOU SAY THAT U S WEST’S WHOLESALE DEAVERAGED**
11 **ZONES ARE NOT COST BASED?**

12 A. U S WEST deaveraging proposal is based upon their current retail deaveraging
13 proposal. Based on the retail proposal, U S WEST calculates costs, using a cost
14 model that is not designed to calculate cost differences within the state, and
15 determines what they call, “cost related” zones. U S WEST calls the zones “cost
16 related” because the cost for each zone is related to their cost model estimate of
17 costs in that zone.

18 U S WEST cost’s are not, however, cost based. Cost-based zones mean that cost
19 is the basis for creating zones. Since the purpose of establishing deaveraged rates
20 is to facilitate competition by setting the prices of UNEs closer to the actual cost,

1 clearly cost should be the basis for establishing zones. U S WEST fails to use
2 cost as a determinant for establishing deaveraged loop prices and thus their
3 deaveraged proposal, though related to cost, is not very cost reflective.

4 The Commission should consider what proposal best relates prices to cost. Any
5 proposal is cost related, as long as a cost model is used to determine zone costs.
6 U S WEST has implied in a variety of proceedings that since all proposals include
7 some degree of averaging of costs all proposals are equal in their cost relatedness.
8 This is not true. Clearly a proposal that uses cost as the basis for establishing
9 zones, such as AT&T's proposal does, is superior to a proposal that ignores costs,
10 such as U S WEST's proposal.

11 **Q. WHY DO YOU SAY THAT U S WEST'S PROPOSAL EXHIBITS**
12 **VIRTUALLY NO DEAVERAGING?**

13 A. U S WEST deaveraging proposal places 95 percent of its Arizona customers in
14 the least-cost zone. This proposal fails to create deaveraged prices for 95 percent
15 of U S WEST customers in the state. Using U S WEST's philosophy, placing one
16 customer in one zone and all other customers in another zone would satisfy the
17 FCC requirement of deaveraging. The purpose of deaveraging is to facilitate
18 competition by sending the appropriate cost signals to the marketplace.
19 Deaveraging methodologies that seek to mask costs do not comply with the spirit
20 of the deaveraging rule.

A. Yes. U S WEST calculated deaveraged costs after the sale of exchanges – its calculations show an increase in costs in the low-cost zone. This does not make sense. U S WEST is selling off their higher cost wire centers in the state. Logic dictates that when these high-cost wire centers are sold, the statewide average costs should fall. The wholesale costs in the low-cost zone should either remain unchanged (if nothing in zone one is being sold) or decrease. The fact that U S WEST calculations show an increase in the low-cost zone and a reduction in the high-cost zones, when high-cost wire centers are sold, should bring serious doubt upon U S WEST's methodology and deaveraged cost calculations.

III. CONCLUSION

Q. WHAT CONCLUSIONS CAN BE DRAWN FROM YOUR TESTIMONY?

A. Both AT&T and U S WEST agree that the loop is the most important element to deaverage. AT&T and U S WEST disagree on the number of zones and the appropriate way to define zones within the state. AT&T proposes defining zones based on cost differences that exist within the state of Arizona. U S WEST proposes to define zones based on their current retail zone deaveraging proposal.

1 Methodologies other than grouping similar cost areas together, as proposed by
2 AT&T, distort UNE prices and diminish the benefits that can be derived from
3 deaveraging.

4 AT&T recommends the use of the deaveraged loop rates and zones identified in
5 Attachment A to Mr. Denney's direct testimony.

6 **Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

7 **A. Yes.**